UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLUMBIA

In re	)	
	)	
SOUTHERN TERRACE, L.P.,	)	Case No. 98-00107
	)	(Chapter 11)
Debtor.	)	
	)	
In re	)	
	)	
BARNABY GARDENS LIMITED PARTNERSHIP,	)	Case No. 98-01648
	)	(Chapter 11)
	)	
Debtor.	)	

DECISION AND ORDER GRANTING JOINT
ADMINISTRATION AND DENYING SUBSTANTIVE CONSOLIDATION

The debtors, Southern Terrace, L.P. and Barnaby Gardens Limited Partnership, have filed a Motion for Joint Administration and Substantive Consolidation. Ocwen Federal Bank, F.S.B., has opposed the motion insofar as the motion seeks substantive consolidation. The court will deny the motion insofar as the motion seeks substantive consolidation because it sets forth insufficient allegations warranting substantive consolidation. There is no reason why the question of consolidation should not await plan confirmation, as is the usual course. Chemical Bank N.Y. Trust Co. v. Kheel, 369 F.2d 845, 847 (2d Cir. 1966).

The Code nowhere specifically authorizes consolidation of separate estates, but courts may order consolidation by virtue of their general equitable powers. Drabkin v. Midland Ross Corp. (In re Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987), citing In re Continental Vending Mach. Corp., 517 F.2d 997, 1000 (2d Cir. 1975), cert. denied, 424 U.S. 913 (1976).

Substantive consolidation usually results in the pooling of

the assets and liabilities of the two entities so that the joint liabilities may be satisfied from the resultant fund. It eliminates inter-entity claims and combines the creditors of the two entities for the purpose of voting on reorganization plans. Union Sav. Bank v. Augie/Restivo Baking Co. (In re Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988). "The power to consolidate should be used sparingly because of the possibility of unfair treatment of creditors of a corporate debtor who have dealt solely with that debtor without knowledge of its interrelationship with others." Kheel, 369 F.2d at 847.

Substantive consolidation may have a serious impact on creditors' recoveries "because every entity is likely to have a different debt-to-asset ratio, [so that] consolidation almost invariably redistributes wealth among the creditors of the various entities." Auto-Train, 810 F.2d at 157. "Creditors of the less solvent entities (i.e., the entities with lower ratios of assets to liabilities) will benefit from the higher asset-to-liability ratio of the consolidated entity, while creditors of the wealthier entity will necessarily suffer reduced recoveries as a result of consolidation." Mary E. Kors, Altered Egos: Deciphering Substantive Consolidation, 59 U. Pitt. L. Rev. 381, 382 (1988).

In Auto-Train, the D.C. Circuit articulated by way of dicta the following test for substantive consolidation:

1. The proponent must show a substantial identity between the entities to be consolidated and that consolidation is necessary to avoid some harm or realize some

benefit.

2. At this point, a creditor may object on the ground that it relied on the separate credit of one of the entities and that it will be prejudiced by the consolidation.

3. If the creditor makes such a showing, then the court may order consolidation only if it determines that the demonstrated benefits of consolidation "heavily" outweigh the harm.

Auto-Train, 810 F.2d at 276. Consistent with that dicta is the observation in Augie/Restivo, 860 F.2d at 518, that the various factors the courts have considered in addressing substantive consolidation

> . . . are merely variants on two critical factors: (i) whether creditors dealt with the entities as a single economic unit and "did not rely on their separate identity in extending credit," or (ii) whether the affairs of the debtors are so entangled that consolidation will benefit all creditors. [Citations omitted.]

Neither factor is present here.

The debtors' allegations do not even suggest that creditors did not rely upon the separate identities of the debtors in extending credit.

Nor do the allegations show that the affairs of the debtors are so entangled that consolidation would benefit all creditors. There is no allegation that assets have been commingled or improperly transferred between the debtors, or that there has been a muddling of which debtors are liable for what debts.

The debtors have common management and ownership. In addition, NationsBank is a creditor of both estates. NationsBank

lent money to Barnaby Gardens L.P. and obtained a lien upon the real property of Soutern Terrace, L.P. to secure that debt. Barnaby Gardens L.P had been paying the NationsBank debt until it filed its bankruptcy case. With the exception of NationsBank, none of the creditors in the two cases hold claims that are common to the two cases.

These facts do not establish entanglement: sister entities have simply agreed to be liable for the same debt. As explained in Kheel, 369 F.2d at 847:

> in the rare case . . . where the interrelationships of the group are hopelessly obscured and the time and expense necessary even to attempt to unscramble them so substantial as to threaten the realization of any net assets for all the creditors, equity is not helpless to reach a rough approximation of justice to some rather than deny any to all.

When the lines keeping the two entities separate and distinct have been faithfully observed, as here, there is no entanglement.

The debtors additionally point to their proposal of a joint plan. The plan proposes a treatment of NationsBank's claim against the two estates by way of a sale of the property of Southern Terrace, L.P. that would result in NationsBank's allowing part of the proceeds to be used in the Barnaby Gardens L.P. case for other creditors. NationsBank would then have only a $45,000 claim to be paid by the two estates, thus enabling Barnaby Gardens L.P. to devote more of its future income to paying other creditors. But substantive consolidation is not necessarily required to do that: if the criteria for confirmation are met, then the joint plan will be confirmed. In determining

whether the plan should be confirmed, creditors are entitled to the protections of 11 U.S.C. § 1129 as though the two estates had not been substantively consolidated.

In other words, the goal of jointly solving the problems of the two estates by merging them as one is not necessarily impermissible; but that perhaps laudatory goal cannot justify use of substantive consolidation before plan confirmation. The end cannot justify the means.

In accordance with the foregoing, it is

ORDERED that the debtors' motion is partially granted and partially denied as set forth below. It is further

ORDERED that these cases are to be and hereby are jointly administered, but the request for substantive consolidation is denied. It is further

ORDERED that all papers other than proofs of claims shall be filed with the following caption:

In re	)	
	)	
SOUTHERN TERRACE, L.P.,	)	Case No. 98-00107
	)	(Chapter 11)
Debtor.	)	
	)	**JOINTLY ADMINISTERED WITH:**
In re	)	
	)	
BARNABY GARDENS LIMITED PARTNERSHIP,	)	Case No. 98-01648
	)	(Chapter 11)
	)	
Debtor.	)	

It is further

ORDERED that all papers other than proofs of claims shall be filed and docketed only in Case No. 98-00107.

Dated: February 5, 1998.

_____
S. Martin Teel, Jr.
United States Bankruptcy Judge

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